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Solving the Employee Reference Problem: Lessons From the German Experience†

Employers in the United States confront an inability to secure references for prospective employees due to the American legal environment which does not require that references be given. References are legally mandated in Germany. This Article explores the workings of these two legal regimes. Although it does not recommend the adoption of a mandatory reference system, it argues that much can be learned from the German experience. It proposes the creation of a legal safe harbor for a voluntary reference pool.

I. INTRODUCTION

The United States has a problem: employers have become extremely reluctant to supply references about employees. As a result, a number of states have legislated to encourage employers to be more forthcoming, short, however, of mandating that references be provided. The Federal Republic of Germany does not have this problem: it has long mandated that references be given. But that mandate has generated a complex body of law and a whole semantic system that has fed into a growing number of legal complaints.

This Article will first describe the situation in the United States, in practice and in law. It will next do as much for Germany. To the obvious follow-on question of whether the United States should consider borrowing the German system, the short answer will be no. But the more interesting question is whether the United States can learn from the German experience in devising a solution attuned to Ameri-

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† This Article combines and refines the discussion by Kenneth Dau-Schmidt, *Employment in the New Age of Trade and Technology: Implications for Labor and Employment Law*, 76 IND. L.J. 1, 15-17 (2001) and by Matthew Finkin, *From Anonymity to Transparency: Screening the Workforce in the Information Age*, 2000 COLUM. BUS. L. REV. 403, 442-46 (2000) and Matthew Finkin, *Employee References: A Very Small Study in Comparative Law*, in Festschrift für Bernhard Großfeld 265 (Ulrich Hüber & Werner Ebke eds., 1999). It was delivered by Professor Finkin as the Rush McKnight Labor Law Lecture at the Case Western Reserve Law School on January 31, 2008. The authors are indebted to members of that audience for their comments and suggestions.

can circumstances. The answer to that will be yes: if law can conduce toward a freer flow of accurate information in the labor market, companies will act accordingly. In other words, the German experience deepens the economic analysis of legal options and legitimates a more active role for law even if that law does not necessarily track the German system.

II. THE UNITED STATES

A. *The Current State of Affairs*

In 1992, Ramona Paetzold and Steven Willborn drew attention to the radical decline in the willingness of employers to provide references on prior employees, other than, perhaps, the bare bones of dates of hire and job duties.¹ They attributed this unwillingness to the fear of being sued for defamation and they went on to document the irrationality of that decision: employers were no more likely to be sued—more precisely, no more likely to be sued successfully—than they had been a generation before when the giving of references was a standard operating procedure.²

The consequence is serious both to individuals and to business. As J. Hoult Verkerke has explained, incomplete and asymmetric information in the labor market conduces toward three market imperfections: mismatching—a lack of fit between the candidate and the job; churning—unproductive job turnover; and scarring—the wrongful stigmatization of persons who profitably could be employed.³ “In an ideal world,” he tells us,

Prospective employers would be able to rely on a full and candid disclosure form [*sic*] an applicant's former employers to decide whether the reasons for a particular employment termination disqualify him or her from consideration for a job. The problems of mismatching, churning, and scarring cannot occur in a full-information equilibrium.⁴

But today's world is far from ideal: it has been reported that forty percent of applicant resumes have discrepancies in educational or

1. Ramona Paetzold & Steven Willborn, *Employer (Ir)rationality and the Demise of Employment References*, 30 AM. BUS. L.J. 123 (1992).

2. In 1979, the Conference Board surveyed 6,000 companies with a response of between 500 and 600 respondents in each of four sectors—manufacturing, gas and electric utilities, banking, and insurance—on their personnel practices. The survey indicated that, in total, these companies checked on applicants' work references about ninety-seven to ninety-eight percent of the time. Harriet Gordin, *Personnel Practices I: Recruitment, Placement, Training, Communication*, The Conference Board Information Bulletin No. 89 (1981).

3. J. Hoult Verkerke, *Legal Regulation of Employment Reference Practices*, 65 U. CHI. L. REV. 115 (1998).

4. *Id.* at 149.

employment history;⁵ and, in the absence of good information on how employees have actually performed in prior employment, prospective employers have increasingly resorted to searches of matters of record, private as well as public, as part of the employment process.⁶

The want of employer forthcomingness has been addressed legislatively. Florida enacted a job reference law in 1991. Colorado did as well in 1992; and Alaska did in 1993. But the legislative floodgate opened shortly thereafter: nine states acted in 1995, twelve in 1996, and another five in 1997—more than half the states in total. (Seven more were to go on to address the issue.⁷) These statutes differ in detail and pose a number of as yet unanswered technical questions catalogued by Markita Cooper.⁸ For the most part, however, they are devised to discourage groundless litigation by calibrating the qualified privilege the common law accords to job references: they create a statutory presumption of good faith that shifts the burden from the employer, to defend a defamation claim by invoking the privilege, to the plaintiff-employee to defeat it, at least in those jurisdictions where heretofore the burden rested differently. In essence, as the Supreme Court of Rhode Island observed of its statute, this approach does little more than to codify the common law.⁹ Unlike German law, the states have not mandated that references be given.

As of 2001, these laws had not had their desired effect.¹⁰ Professor Cooper speculated at that time that as these laws were still relatively new, over time employers “may become increasingly aware of the statutes and more willing to rely on the immunity” they cod-

5. John Matejkovic & Margaret Matejkovic, *Whom to Hire: Rampant Misrepresentations of Credentials Mandate the Prudent Employer Make Informed Hiring Decisions*, 39 CREIGHTON L. REV. 827, 832 (2006).

6. MATTHEW FINKIN, *PRIVACY IN EMPLOYMENT LAW*, ch. 4, § II (2d ed. 2003).

7. The texts of these laws are set out in *id.*, Pt. II.

8. Markita Cooper, *Job Reference Immunity Statutes: Prevalent But Irrelevant*, 11 CORNELL L.J. & PUB. POL’Y 1 (2001). The Missouri statute is discussed in Note, *The New Missouri Employer Immunity Statute: Are Missouri Employers Still Damned If They Do and Damned If They Don’t?*, 44 ST. LOUIS U. L. REV. 693 (2000). The Ohio statute is discussed in Comment, “To Tell the Truth, the Whole Truth, and Nothing but the Truth”: *Employment References and Tort Liability*, 33 U. TOL. L. REV. 847 (2002). The Idaho statute is discussed in Note, *The Need for Change in Idaho’s Reference Immunity Statute: A Proposal to Immunize Idaho Employers’ Exposure to Negligent Hiring Claims After Doe v. Garcia*, 35 IDAHO L. REV. 343 (1999).

9. *Kevoorkian v. Glass*, 913 A.2d 1043, 1048 (R.I. 2007). See also *Frank v. Home Depot, U.S.A., Inc.*, 481 F. Supp. 2d 439 (D. Md. 2007). In *Champan v. Ebeling*, 945 So.2d 222 (La. App. 2006), the prior employer’s allegedly defamatory remarks were made to a reference checker retained by the prior employee. Inasmuch as the Louisiana reference law applies only to information given “upon request of a prospective employer or a current or former employee,” the issue was treated as a matter of common law—in fact, the statute was never mentioned—the result analytically and practically remaining exactly the same. Similarly, in *Wylie v. Arnold Transp. Services, Inc.*, 494 F. Supp. 2d 717 (S.D. Ohio 2006), the court analyzed the issue as a matter of common law, ignoring *Ohio Rev. Code Ann. § 4113.71* (2001) but reaching the same result the statute would command.

10. Cooper, *supra* note 8, at 44-45.

ify.¹¹ Three years later, that is six years after the wave of reference protective law crested, the situation has actually worsened.

In 1998, the Society for Human Resource Management (SHRM) surveyed 2,640 of its member human resource (HR) professionals concerning their practices and experiences regarding background and reference checks: 854 responded (thirty-two percent), representing a cross-section of enterprises, enterprise size, and geographic locations.¹² In 2004, SHRM repeated the survey, this time of 2,500 HR professionals with a response of 345 (eighteen percent); but this survey was less weighted toward manufacturing and more toward services than in 1998,¹³ better to reflect the distribution of jobs in the economy. The distribution of firm size remained roughly the same.¹⁴

In 1998, forty-five percent of the respondents stated that their organizations refused to provide *any* information on a former employee for fear of litigation. In 2004, the share of respondents who stated they refused to provide any information increased to fifty-three percent. This increase occurred even though the incidence of litigation remains a miniscule two percent or less.¹⁵ The 1998 survey was accompanied by a white paper on the spate of reference protective laws then recently enacted. The author was dubious, absent a “sure-fire ‘guaranty’ of immunity,” that these measures would be of any practical effect:

Just as employers have been reluctant to provide extensive reference information even though the common law provides qualified immunity, most employers are likely to continue to minimize the risk of liability simply by withholding information. In short, it is easier to keep quiet about an employee than to even risk the threat and expense of litigation.¹⁶

11. *Id.* at 46.

12. SHRM, 1998 Reference Checking Survey (1999).

13. SHRM, 2004 Reference and Background Checking Survey Report (Jan. 2005).

14. The respective responding sample of HR managers was:

Frequency of Responding HR Managers by Industry (%)		
Industry	1998	2004
Manufacturing	26	16
Services (Profit & Non-Profit)	13	21
Health Services	11	11

15. The percent of firms reporting defamation claims as a result of references on prior employees in the prior three years was only one percent in the 1998 survey and two percent in the 2004 survey. In 2004, the survey also asked whether the firm had been accused in the prior three years of failing to warn another employer about a former employee who harms or commits a crime at another job. Only one percent of respondents answered yes to this question. SHRM 1998 and 2004 *Survey Reports*.

16. Donn Meinderstma, *Implications of the 1996 Job Reference Immunity Statutes*, in 1998 SHRM Survey, *supra* note 12, at 28.

As Table 1 shows, the author's skepticism was well placed. In Table 1 we summarize the findings of the SHRM surveys for 1998 and 2004 with respect to the frequency of the type of information the respondents report providing as a percentage of the entire sample. For ease of analysis the critical tendency, set out in the last column, is the percentage of companies that *never* give out the information requested. These percentages are summarized in Graph 1. These percentages show that, despite the small chance of being sued because of the contents of a job reference, the proportion of employers who report that they never report reference information is growing and well over fifty percent for all types of information except for dates of employment—and fifty-three percent of employers no longer provide even *that* innocuous bit of information. At the other end of the spectrum a full seventy-six percent of respondents said that they never report even violent or bizarre behavior.

TABLE 1: FREQUENCY OF REFERENCE INFORMATION
PROVIDED WHEN REQUESTED (%)

	1998				2004			
	Regularly	Sometimes	Rarely	Never	Always	Sometimes	Rarely	Never
Dates of employment	98	1	<1	<1	46	2	0	53
Eligibility for rehire	42	21	9	28	17	15	4	64
Salary history	41	24	15	20	13	16	7	65
Reason candidate left previous employer	19	23	19	39	8	16	6	71
Qualification for a particular job	18	23	16	43	5	14	7	74
Overall impression of employability	16	22	17	45	4	15	7	74
Work habits (absence, tardiness, etc.)	13	19	21	47	2	15	7	75
Human relations skills	11	21	19	49	3	13	10	74
Personality traits	7	14	24	55	1	9	12	78
Violent/bizarre behavior	8	12	25	55	5	10	9	76

SOURCE: 1998 and 2004 SHRM *Survey Reports*. Total may exceed 100% due to rounding.

In other words, a state of affairs that is, behaviorally, law-reactive and that has deleterious societal consequences—on both individuals and, in the aggregate, on business—is likely to persist despite a widespread effort at legal remediation. The question is whether a different approach to remedy this situation should be pur-

GRAPH 1: PERCENTAGE OF HR MANAGERS REPORTING THAT THEY NEVER DISCLOSE INFORMATION IN THE LISTED CATEGORIES

sued; but because the problem is in part law-driven, the current state of the law needs first to be sketched.

B. Sources of Potential Liability

The common law imposes no duty on an employer to give a reference—or a “character” as it was commonly called in the nineteenth century. The reason for this rule was explained by a British treatise of 1897:

[I]f a master were compelled to give a character, it would necessarily follow that he must be held to the proof of the character he gives. The burden then cast on the master would often give rise either to much litigation on the one hand or to the giving of false characters on the other.¹⁷

In this passage, the treatise writer assumes that as there would be no liability for the giving of a falsely positive reference, employers would game a reference obligation to avoid liability by giving positive references across the board; but this is said even as the treatise writer opines elsewhere that consequential damages *would* be due to the prospective employer who relies to its detriment on a knowingly false recommendation.¹⁸ An American treatise stated the governing rule to just that effect in 1913:

17. ERNEST A. PARKYN, *THE LAW OF MASTER AND SERVANT* 133 (1897).

18. *Id.* at 140.

The effect of the authorities seems to be that, where A, by making statements or *by suppressing facts* regarding X, induces B to employ X as an agent, A is liable for such damages as B may sustain through the misconduct of X, although A had no intention of injuring B, or of benefiting himself.¹⁹

The two situations—of false negatives that might injure former employees and false positives that might injure prospective employers—should be analyzed separately. As will be seen later, the German reference law covers both situations; the former directly, the latter obliquely.

1. False Negatives

The utterance (or “publication”) to any third party of an erroneous fact that injures a person’s ability to practice her trade or profession—in most jurisdictions, her ability to secure a job—works a defamation. Note that the communication must be of an injurious and erroneous fact. Truth is an absolute defense; and non-factual assertions—expressions of mere “opinion”—are not actionable unless the statement expressly or tacitly conveys a factual and so testable predicate.

It is universally recognized that when such a communication, at once false and injurious, is made by a prior employer to a prospective employer it is protected nevertheless by a qualified privilege.²⁰ I.e., the law recognizes that some injurious falsehood may inevitably be uttered in the reference process and that it is better for society that references be communicated even at the cost of possible reputational

19. 5 C.B. LABATT, COMMENTARIES ON THE LAW OF MASTER AND SERVANT § 2033 at 6306 (2d ed. 1913) (emphasis added) (references omitted). The “authorities” cited are two. *Foster v. Charles*, 7 Bing. 103 (1830) (the facts are detailed in 6 Bing. 396 (1830)), which does support the proposition, and *Wilkin v. Reed*, 15 C.B. 191 (1854), which is far less categorical. In that case a lawyer had recommended a clerk to another lawyer, to manage the latter’s office. The clerk had stolen from the first lawyer but had repented and been forgiven. He was actually terminated by the first lawyer because of a fall off in business, which was the reason given for his discharge to the second lawyer. After the clerk was hired, he embezzled from his new employer. The second lawyer sued the first for fraud, for misstating the true ground of discharge. As the ground of discharge was in fact the one given, the plaintiff sought to amend his pleading to allege wrongful suppression of the employee’s prior bad act. Thus the court disallowed amendment on procedural grounds; that was the holding in the case. But in dictum on whether that suppression would have been actionable the judges were dubious: Judge Crowder and Chief Judge Jervis opined of such suppression that there was “no ground of action” and “no cause of action” respectively, but without explanation. In colloquy, Judge Creswell observed, “Many cases might be supposed where it would not only be unnecessary, but cruel and unjustifiable, to disclose a sin of which the clerk had repented, and for which he had obtained forgiveness.”

20. The Connecticut Supreme Court, in what it termed a case of first expression in that jurisdiction, recently acknowledged and joined in that view. *Miron v. University of New Haven Police Dept.*, 931 A.2d 847 (Conn. 2007).

injury, and the particular plaintiff's loss of a prospective job or jobs, than that they not be communicated at all. What would cause the privilege to be defeated in some jurisdictions is actual malice, a lie told with an intent to injure; or legal malice, a lie told with knowledge of its falsity or with reason to know its falsity when uttered—sometimes called “reckless or wanton disregard” of the truth of the matter asserted; or, in a few jurisdictions, a lie told with belief in its truth but uttered without adequate investigation into the truth of the matter.²¹ For the most part, the recent reference statutes apply the actual or legal malice standards and place the burden of proof on the plaintiff to negate a statutory presumption of good faith accorded the employer.

2. False Positives

A false positive can consist either of a factual misstatement or the suppression of a fact that would bear upon the employee's likely future performance or behavior, e.g., a statement that the prior employee was at all times in good standing when in fact she had resigned under threat of discharge for misconduct. The early treatise writers just discussed maintained that both British and American law would hold employers accountable for a reference's misstatement or suppression on which a prospective employer relies and as a result of which it suffers consequential damages. Whether that account was accurate and whether (and why) the law changed, if, indeed, it has, it suffices to say here that several more recent U.S. cases proceed from the contrary assumption: that ordinarily a prior employer is not liable to the current employer or to some other third party—the current employer's employees or clients who might be injured by the prior employee's misconduct—on the theory that there is no duty to warn in the absence of a “special relationship” to a foreseeable victim.²²

In *Neptuno Treuhand- und Verwaltungsgesellschaft MBH v. Arbor*,²³ to take a rather striking example, Neptuno, a German company, agreed to hire an American commodities future trader on the express condition that he provide a letter of reference from his prior employer “attesting to his experience, competence and integrity as a commodities future trader.”²⁴ The former employer provided the following:

21. The caselaw is collected by FINKIN, *supra* note 6, at 192-93, 195-99. Publication to a wider audience than is necessary for the purpose of the privilege will also defeat it. *Id.* at 324-28. See, e.g., *Rosen v. Mendivil*, 225 S.W.3d 181 (Tex. App. 2005).

22. E.g., *Murdock v. Higgins*, 559 N.W.2d 639 (Mich. App. 1997); *Franconi v. Rault*, 521 So. 2d 1189 (La. App. 1988); *Cohen v. Wales*, 518 NYS 2d 633 (App. Div. 1987) (failure of prior employer to reveal teacher's sexual misconduct to prospective employer).

23. 692 N.E.2d 812 (Ill. App. 1998).

24. *Id.* at 814.

I have known Tom Farrell personally for over 13 years. He was an active full member of the Chicago Board of Trade. Tom has always proven to be an intelligent industrious and innovative young man.²⁵

What the letter did not reveal was that Farrell was under an order from the Chicago Futures Trading Commission (CFTC) barring him for two years from trading on his own account or in any other account in which he had an interest and that his brokerage registration had been permanently revoked. Farrell was hired on the strength of this reference and proceeded to trade beyond the limit Neptuno placed on him resulting in a loss to Neptuno of \$5 million. Neptuno sued Arbor, the former employer, for the failure to disclose—and lost. The court held there was no duty to disclose; but, the court also reasoned that as the CFTC's actions were a matter of public record, Neptuno's sole reliance on the letter in making its hiring decision, its failure more fully to investigate Farrell's background, was unreasonable.

However, other jurisdictions have imposed a duty of candor in disclosure: in two cases where the suppressed information concerned the prospect of "risk of foreseeable physical harm" resulting from the employee's hire;²⁶ and, in a third, where a reference on a bookkeeper failed to state that the employee had been discharged for theft and had been convicted for it.²⁷ The facts alleged in the latter were sufficient to survive a motion to dismiss even though a criminal background check could have been conducted; that is, as in *Neptuno*, there were other means available to learn of the applicant's record.

In sum, the courts at present seem to be at 6s and 7s on liability for falsely positive or misleading references. The issue of non-disclosure is especially vexing because, even as with hindsight one might well discern a causal chain in a non-disclosure resulting in physical

25. *Id.*

26. *Davis v. Board of County Commissioners*, 987 P.2d 1172, 1182 (N.M. App. 1999) (corrections officer about to be subject to disciplinary hearing for the sexual abuse of inmates was given a glowing recommendation without mention of the pending charges); *Randi W. v. Muroc Joint Unified School Dist.*, 929 P.2d 582 (Cal. 1997) (school administrator forced to resign for engaging in sexual misconduct with a student was given a reference recommending him "without reservation" and molested a student in the school that hired him).

27. *Fluid Technology, Inc. v. CVJ Axles, Inc.*, 964 P.2d 614 (Colo. App. 1998). The court followed the Restatement (Second) of Torts § 552(1) (1976), finding there to be a "pecuniary interest" on the prior employer's part in the transaction, i.e., that the want of any consideration going to the prior employer did not mean that it did not have a pecuniary interest in the transaction. However, the court does not identify what that pecuniary interest was save that the recommendation was given in the course of the business. If that reading is correct then the courts that have found no duty have all erred. This reading of § 552(1) was explicitly rejected by the Washington Court of Appeals in *Richland Sch. Dist. v. Mabton Sch. Dist.*, 45 P.3d 580, 586 (Wash. App. 2002), discussed *infra*.

harm or economic loss and which could drive a court toward a finding of liability, one can also conceive of circumstances where the disclosure of potentially harmful information might well be unnecessarily prejudicial or injurious to the employee at the time.²⁸

How delicate this judgment might be is illustrated in the decision of the Washington Court of Appeals in *Richland School District v. Mabton School District*.²⁹ A school custodian who had worked for Mabton was criminally charged with child molestation. In return for the dismissal of the criminal charge he agreed to resign as custodian; but the school district, after concluding its own investigation, rehired him as a school bus driver. It also gave him a glowing letter of recommendation as a custodian and, a year later, he was hired as a custodian by Richland. After a Richland student, the custodian's nephew, complained of the custodian's having inquired of where he, the nephew, was living, Richland investigated the employee's background, discovered the prior criminal charge, and dismissed him in part for falsifying his employment application by failing to mention that episode. The discharge was taken to arbitration by the custodian's union and he was exonerated. The arbitrator noted "the tension between the public policy of presumed innocence and the need to protect children from abuse."³⁰ Nevertheless,

The arbitrator's 74-page decision thoroughly examines the facts leading up to Mr. Caballero's [the custodian] criminal charges and the complaint by the nephew. According to the record before the arbitrator, the allegations of molestation (involving members of his wife's family) changed during the course of the investigation, were disputed among family members, appeared to be tied to divorce proceedings, and were treated by Mabton officials as a "family squabble." . . . Because Mabton regarded Mr. Caballero as innocent of the charges, it hired him as a substitute bus driver after he resigned.³¹

Richland then sued Mabton for the payments it made to the custodian to settle the matter post-arbitration and for the cost of the arbitration. The Washington Court of Appeals held that Mabton could not be liable for not disclosing that which the employee did not wrongly withhold:

The charges of child molestation apparently were not confirmed by the police investigation and were dismissed, albeit with the proviso that Mr. Caballero agree to resign from the

28. See *supra* note 19.

29. 45 P.3d 580 (Wash. App. 2002).

30. *Id.* at 585.

31. *Id.* at 584.

school district. Mabton officials, with some personal knowledge of the parties involved in the allegations, decided that the charges were baseless.³²

Prospective employers commonly inquire why the applicant left and examine his eligibility for rehire.³³ From what appeared, the custodian left his position voluntarily and had been rehired in another capacity involving student contact. Thus the question was whether Mabton should have volunteered that the custodian resigned from that custodial position on condition of withdrawal of criminal charges. That statement would have been accurate as far as it went—but as a partial account it would have been misleading. Should a more complete statement, e.g., that the custodian had “resigned on condition of the withdrawal of what the administration believed were baseless criminal charges of child molestation,” have been made or would *that* have been unduly prejudicial? Is that decision better made in hindsight, a judgment of what should have been said in light of subsequent events, or might it better be secured in advance of disclosure, as a protection for the employee’s job prospects and a safe harbor for the employer? Do the twin goals of accuracy and fairness suggest that the person affected, the employee, should be able to be heard on the content of the reference? As we will see later, German law does so by allowing the content of the reference to be challenged. We will return to this aspect toward the close.

C. Remedial Alternatives

Four options have been discussed: (1) better managerial education, (2) absolute privilege, (3) the market, and (4) mandatory references. Let us look to each.

1. Education

It may be that as the need for accurate references becomes ever more pressing, employers will come to realize the irrationality of their overreaction to the prospect of litigation. A business columnist has recently opined that, “in the real world”—that is, despite fear of lawsuits—“more people appear to be agreeing to give references,” as employers recognize the importance of sharing such information “to both the employer and the employee,” quoting an owner of an online career information company.³⁴ Even though that would solve the problem, no data supporting the “appear to” have been supplied.

32. *Id.* at 587. The court concluded that the alleged misrepresentations failed to present a “substantial, foreseeable risk for physical injury in that any person suffered physical harm.” *Id.*

33. *See supra* Table 1.

34. Phyllis Korkki, *The Care and Feeding of References*, N.Y. TIMES (Sept. 2, 2007), Sunday Business, at 15 (quoting Mark Oldman of Vault.com).

From what appears, the current state of affairs seems likely to persist.

2. Absolute Privilege

The law might accord references an absolute privilege instead of a qualified one. The Kansas reference law moves in this direction. It accords an absolute privilege from any civil liability for the communication of dates of employment, pay level, job description and duties, and wage history; and it extends this immunity to supplying the following upon the written request of a prospective employer:

- (1) written employee evaluations which were conducted prior to the employee's separation from the employer and to which an employee shall be given a copy upon request; and
- (2) whether the employee was voluntarily or involuntarily released from service and the reasons for the separation.³⁵

To similar effect, the New York Court of Appeals has accorded an absolute privilege to the contents of Form U-5 mandated by the National Association of Securities Dealers giving the employer's reason for the termination of a broker, which forms are made accessible to prospective employers and customers.³⁶ The latter decision was not without dissent, however, for an absolute privilege allows the prior employer to speak with impunity.³⁷

The prospect of abuse is real.³⁸ Accordingly, the question becomes whether the societal need for informational transparency justifies the adventitious injury that a qualified privilege might require an employee to endure (except for the sufferance of intentional

35. Kan. Stat. Ann. § 44-119a (2000).

36. *Rosenberg v. Metlife, Inc.*, 866 N.E.2d 439 (N.Y. 2007).

37. *Id.* at 445, 446 (Pigott, J., dissenting). *Cf.* *Moore v. St. Joseph Nursing Home, Inc.*, 459 N.W.2d 100 (Mich. App. 1990), declining to impose an obligation to reveal harmful information. "It is all too easy to envision a career destroyed by malefic information released by a disgruntled employer." *Id.* at 102.

38. In Maine the U-5 is subject to a qualified, not an absolute privilege. *Galarneau v. Merrill Lynch, Pierce, Fenner & Smith*, 504 F.3d 189 (1st Cir. 2007). In that case, a jury verdict for the terminated broker on the basis of the content of her U-5 was sustained. There was adequate evidence for the jury to conclude that the ground given for her discharge, that she had "engaged in inappropriate bond trading on a client's account," for trades made subject to Merrill Lynch's review and approved by it, was uttered either with knowledge of falsity or in reckless disregard of the truth. In *Rosensweig v. Morgan Stanley & Co., Inc.*, 494 F.3d 1328 (11th Cir. 2007), a broker claimed the Form U-5 worked in the tort of intentional interference in prospective economic advantage in an arbitration under the rules of the National Association of Securities Dealers: i.e., that the ground given for his termination was not true and was given in order to prevent his gaining employment as a broker in that area. The arbitrator agreed, awarded damages, and ordered the record expunged. The Court of Appeals enforced the arbitrator's award in full.

or wanton harm).³⁹ It is doubtful that we should be prepared to allow an employer to escape legal scrutiny altogether when, for example, it knowingly asserts a completely baseless accusation of malfeasance as the ground of discharge,⁴⁰ uses the reference as a retaliatory device,⁴¹ or uses the threat of a malicious reference as a disciplinary cudgel. This option would be a disproportionate response to the reference problem.

3. The Market

The reference problem poses an interesting conundrum for the market since three parties have divergent interests in its outcome. The first employer has an interest in using references to encourage and reward good work and to discourage and punish bad performance. Unfortunately it may be costly to the first employer to produce an accurate reference, and unscrupulous employers may use references for personal revenge. The employee has an interest in a positive reference, to reward him for a good performance, or to allow him to escape the costs of a bad performance. The second employer has an interest in an accurate reference to allow him to pick the best prospective employee and match employees to appropriate jobs. Although their interests diverge, there is little doubt that the parties, and society as a whole, have an interest in the accurate production of reference information to encourage and reward good work and accurately to match employees to their jobs.

These divergent interests make it difficult for any two of the three parties adequately to resolve this problem through contract negotiations. If negotiations are left to only the first employer and the employee, the obvious solution is to tend toward a positive reference. Effective liability on the part of the first employer to the second for a false positive is necessary to check this effect. If negotiations are left to only the first and second employer, the first employer would tend

39. In *Butler v. Delaware Otsego Cop.*, 650 NYS 2d 483 (App. Div. 1996), the malicious disclosure of harmful information from an employee's personnel record was held actionable. If the disclosure were to meet one of the categories set out in the Kansas law it would not be actionable in that jurisdiction.

40. *El-Hadad v. United Arab Emirates*, 496 F.3d 658, 661 (D.C. Cir. 2007) (employee bad faith deprived the utterance of qualified privilege).

41. In *Pasqualini v. Mortgageit, Inc.*, 498 F. Supp. 2d 659 (SDNY 2007), the prior employer informed a prospective one that the employee is "a psychopathic liar and whore who repeatedly makes fraudulent complaints about her co-workers and superiors merely to cover up for her own laziness and incompetence [.]". The employee, a manager at a mortgage lender, had complained that a senior loan officer repeatedly touched her forcibly on her buttocks and breast. As he was the company's "top earner," *id.* at 663, the employee alleged that the company did nothing. Eventually, the employee filed a criminal complaint against the loan officer. The loan officer pleaded guilty and a permanent order of protection was entered in the employee's favor. The employee asserted that her superiors told her she "would pay for what she did" and terminated her. The statement quoted was allegedly made by her superior to a prospective employer nine months after she commenced a lawsuit against the firm.

to give negative evaluations since this would tend to limit the possibility of later damages on breach of contract.⁴² Effective liability on the part of the first employer to the employee for a false negative is necessary to check this effect and the possibility of personal revenge. Once third party liability to either the second employer or the employee is a possibility, this creates what Verkerke has described as the "coordination problem" in that the second employer who receives the reference gets all of the benefit of the reference and none of the liability risk, and the first employer who produces the reference bears all of the risk of liability and gets none of the benefit of the reference.⁴³ Indeed, as one of us has previously argued, it is the fact that the first employer bears only potential costs and no benefits, not the actual size of potential employer liability for references, which drives the current dearth of job references.⁴⁴

As Verkerke has pointed out, theoretically the coordination problem could be solved by an "ongoing reciprocal arrangement to exchange reference information."⁴⁵

One employer might agree with other local employers to provide candid assessments of former employees who apply to work for those other employers. In return, the other employers would disclose similar information about their former employees.⁴⁶

Unfortunately, as Verkerke also notes, private intermediaries are unlikely to facilitate such exchanges of information because of the asymmetry of information involved and the limitations of pricing. If the intermediary sets one price for a reference, employers will provide references only if they in truth, or by design, have potential liability less than that price. If the intermediary pays more for the really valuable bad or good information, he gives employers incentive to exaggerate the value of their information and distort the reference.⁴⁷

Regardless of the economic theory, it seems clear that in the current legal environment the market is not solving the problem by providing an adequate number of employment references. A reference pool would solve the coordination problem, but if it relies on the mar-

42. The employers might address this problem by making the first employer's compensation for a favorable reference depend in part on the employee's later performance. The fact that we do not see such arrangements commonly in the market suggests that transaction costs in validating the employee's later performance and enforcing the agreement are prohibitive.

43. Verkerke, *supra* note 3.

44. Kenneth Glenn Dau-Schmidt, *Employment in the New Age of Trade and Technology: Implications for Labor and Employment Law*, 76 IND. L. J. 1, 15-16 (2001).

45. Verkerke, *supra* note 3, at 171.

46. *Id.*

47. *Id.* at 171-73.

ket, that is on private agreement, it is incapable of addressing the core of the conundrum which lies in the prospect of legal liability, unless the participants in the pool conclude that the information they secure outweighs the prospect of liability of which some examples can be found, notably in trucking.⁴⁸ Behavior that is law driven, even irrational behavior, may call for a change in law.

4. Mandatory References

The notion most widely discussed is of a mandatory system of reference exchange, which German law accomplishes. Professor Verkerke has argued that mandatory disclosure would be a will o' the wisp: the information of most use to a prospective employer, apart from evidence of demonstrable malfeasance—acts of workplace violence, persistent unexcused absenteeism, and the like—are subjective assessments of productivity, performance, and personality, that are inherently unverifiable.⁴⁹ As he explains,

[E]mployment references normally include subjective performance assessments [T]he underlying observations that support employers' performance appraisals are often far more difficult to verify than a debtor's payment history. In order to defend the truth of their negative judgments, employers must testify about employee shortcomings such as inept or lackadaisical job performance, insubordinate comments or behavior, and the amorphous problem of a "bad attitude." Evidence that is so inherently fluid and indefinite can never be sufficient to prevail on summary judgment [in defamation] and often leaves an employer uncertain about the likely outcome at trial.⁵⁰

48. Some credit reporting agencies cater to specialized labor markets. DAC Services, a subsidiary of USIS, for example, purchases so-called "DAC reports," a standard termination record form setting out entries, akin to that set out in Table 1, *supra*, from participating employers. It estimates that more than 6,000 carriers constituting eighty-five percent of the largest carriers utilize its services. When a trucker applies for a job with a participating carrier he or she will be asked to consent to the screening—actually the release—of his or her DAC report as required by the Fair Credit Reporting Act. See www.thecybertruckstop.com/DS/dac-info.html (last visited Apr. 14, 2008). And in compliance with that Act, if the driver contests the accuracy of the report, DAC Service has to reconfirm with the prior employer. If the prior employer insists on the accuracy of what it said, the employee may place a rebuttal on the record which is attached to the DAC report. Drivers have complained of the systematic abuse this system allows: to blackball "those drivers who stood up for their rights insuring a compliant, more easily exploited work force." Paragraph 19(h) of the Complaint, *in* Owner-Operator Indep. Driver Ass'n., Inc. v. USIS Commercial Services, Inc., 410 F. Supp. 2d 1005 (D. Colo. 2005).

49. *Id.* at 135, 150.

50. *Id.* at 175. He speculated that after the United States Supreme Court's decision in *Milkovich v. Lorain Journal Co.*, 497 U.S. 1 (1990), the courts would most likely find actionable in defamation, as necessarily implying the existence of defamatory negative facts, that which previously was held to be inactionable as mere

In fact, most of the reported appellate decisions in the matter of employee references are on review of decisions on summary judgment, in which, however, employers often prevail. Consequently, the costs that cause employers to shrink from providing references are not necessarily the extensive costs of a trial, to verify the factual grounding of their subjective judgments, but the costs of appearing in court at all: not the prospect of failing to persuade in a motion for summary judgment, but the cost of making the motion.

In the event, Verkerke argues that little would prevent managers from gaming a mandatory reference system by providing only positive references: just as false negatives could routinely be used or threatened to discipline the workforce, false positives could be used systematically to secure voluntary resignations, to “unload undesirable employees on the labor market.”⁵¹ That might be legislated against by requiring truthful assessments but, he argues, such a regime “might prevent employers from signaling their level of satisfaction with former employees by providing positive references with different degrees of enthusiasm.”⁵² And such a prohibition would pose the same problem of verification and the cost of verification as would be imposed on defending a negative evaluation.

Is there a way to test these hypotheses? America has experimented with mandatory disclosure but—with the exception of “service letter” laws enacted at the turn of the twentieth century to combat blacklisting, especially for union activity in railroading⁵³—these are too narrowly focused and specialized to test these propositions.⁵⁴ The service letter laws might provide a legal laboratory, but

expressions of “opinion.” Almost two decades later, that has not happened. Opinion continues to be inactionable. MATTHEW FINKIN, 2008 CUMULATIVE SUPPLEMENT TO PRIVACY IN EMPLOYMENT LAW (2d ed. 2003) at 154 (references omitted) (all references to cases decided in 2002 and subsequently):

Characterizations of an employee as being lazy—or being a “cancer” on the team, or of being incompetent—were held inactionable matters of opinion. Indeed, employers are accorded considerable leeway in how they characterize an employee’s performance, short of allegations of criminal or other serious misbehavior. A college official’s letter observing of a professor who had been denied tenure that he spent too much time on material unrelated to his courses, was rude and “unprofessionally candid” and was inactionable, as opinion, as was a school principal’s mention of a teacher as “burnt out,” “lazy,” “unstable,” and “looking for sympathy.”

Post 1990, as before, however, there is a lack of consistency in just when a court will find an opinion to imply a defamatory fact. *Id.* at 155-56.

51. Verkerke, *supra* note 3, at 166.

52. *Id.* at 168 (footnote omitted).

53. See, e.g., SHELTON STROMQUIST, A GENERATION OF BOOMERS: THE PATTERN OF A RAILROAD LABOR CONFLICT IN NINETEENTH-CENTURY AMERICA 239 (1987). These laws are discussed by F.H. STIMSON, HANDBOOK TO THE LABOR LAW OF THE UNITED STATES § 61 (1907) and FRANK CARLTON, LABOR PROBLEMS 186 (1933).

54. E.g., the Health Care Quality Improvement Act of 1986 requires reporting of adverse actions taken against certain health care practitioners including license revocation, suspension, reprimand, censure or probation, which is to be made available to

with the singular exception of Missouri, these seem to have become dead letters; and the Missouri statute has been read in such a way as to avoid these issues.⁵⁵

Consequently, one might turn to foreign legal systems to see if one might supply a legal experiment whose experience—with all the caution incumbent in considering a different culture, social as well as legal—might shed light on whether the consequences Verkerke essays have been realized. As it turns out, German law has had a long and deep experience with mandatory references and its experience may prove insightful.

III. ZEUGNIS: THE GERMAN LAW OF EMPLOYEE REFERENCES⁵⁶

The roots of modern German reference law have been traced to the police regulations of the sixteenth century where the documentation for migratory miners, artisans, and servants was closely regulated.⁵⁷ The modern law took shape in the Industrial Code of the North German Federation of 1869. A “guiding principle” of the Industrial Code was the freedom of employment.⁵⁸ Consequently, a means was sought for applicants to demonstrate their suitability for hire

health care entities who may be entering an employment relationship with such persons. 42 U.S.C. § 1396r-2 (2000). In addition, the states are required to maintain registries of nurse’s aides including any findings of abuse, neglect or misappropriation of property, which information must be made available on request. 42 C.F.R. § 483.156 (2007). As noted earlier, the National Association of Securities Dealers requires its members to file a form, Form U-5, when an employee is terminated stating the reason for termination; the employee may add a rebuttal on a separate form. These forms are publicly accessible. *See supra* notes 36-37. The Pilot Records Improvement Act of 1996, 49 U.S.C. § 44936 (2000 & Supp. v. 2005), requires a prospective employer of a pilot to secure specified information from those who had employed the applicant within the previous five years, including disciplinary actions, terminations, or disqualifications from employment; and it requires the prospective employee to agree to a release of that information. The law requires that the pilot be given notice that a request for records has been made, be given a copy of the information disclosed (if requested), and be given an opportunity to submit written corrections before a final hiring decision is made. Absolute privilege is accorded the information transmitted in accordance with the Act so long as it is not knowingly false; and state law is preempted. *See Sky Fun 1, Inc. v. Schuttlofell*, 27 P.3d 361 (Colo. 2001).

55. The Missouri law requires the employer to state the “true” cause of the discharge or quit. The Supreme Court of Missouri has held this to mean the cause the employer acted upon must be stated even if it was incorrect. *Labrier v. Anheuser Ford, Inc.*, 621 S.W.2d 51, 57 n.2 (Mo. 1981) (en banc). Thus, if the employee was discharged because the employer erroneously believed the employee had stolen, the statement “discharged for theft” would be a true statement under the Act. *Newman v. Greater Kansas City Baptist & Community Hosp. Ass’n.*, 604 S.W.2d 619 (Mo. App. 1980).

56. For much of what follows, the authors wish to express their appreciation to Rolf Birk, Martin Kraushaar, Sebastian Krebber, Dieter Sadowski, and Spiros Simitis, even as any errors remain the authors’.

57. Hein Schleßmann, *Historisches zum Arbeitszeugnis*, NEUE ZEITSCHRIFT FÜR ARBEITSRECHT [NZA] 2006, p.1392.

58. A. SARTORIOUS VON WALTERSHAUSEN, *DEUTSCHE WIRTSCHAFTSGESCHICHTE 1815-1914*, 227 (1923).

even as employers sought a means to select the better qualified—and to turn away those who had been dismissed for neglect or incompetence or for engaging in a strike or other forms of insubordination.⁵⁹

The problem was addressed in section 113 of the Code. As originally enacted it contained two provisions: (1) that upon leaving employment the worker can demand a certificate stating the type and duration of his employment, and (2) that at the worker's request the certificate is to extend to the worker's conduct (*Führung*). This provision was amended in 1891 to add "performance" (*Leistungen*) to the second clause and to add a provision forbidding employers to affix notations or marks (*Merkmale*) to the certificate with the purpose of characterizing the employee in a manner that is not apparent from the wording. This provision was taken by the industrial arbitration courts (*Gewerbegerichte*) to forbid the use of any symbols, special paper, color, script or stamp that might carry a secret negative meaning;⁶⁰ in effect, to proscribe what in American parlance would be a "blacklist."⁶¹ The former two requirements (as amended) were carried over into the Commercial Code of 1897 and embodied in turn in § 630 of the Civil Code (BGB) in 1900. In 2003, this provision was transferred from the Civil Code to the Industrial Code (§ 109 GewO) including the express prohibition of *Merkmale*.

A. Basic Elements

As one might imagine of a provision more than a century old and actively litigated, there is a substantial body of law and commentary—legal treatises and practical guides⁶²—devoted to the subject of the German job reference law. For our purposes, only the basic elements of the system need be outlined.

At the end of an employment relationship, whether by quit or discharge, the employee is entitled to a written reference (*Zeugnis*) at his or her request. The failure to supply the reference in a timely fashion could result in the award of money damages if the employee can prove the loss of a job or jobs as a result.⁶³

The reference may be either unqualified, i.e., one that gives only the nature and length of the employee's employment, or qualified, i.e., one that gives the employer's estimation of the employee's per-

59. ELAINE SPENCER, MANAGEMENT AND LABOR IN IMPERIAL GERMANY 41-42 (1984).

60. ROBERT VON LANDMANN & GUSTAV ROHMER, KOMMENTAR ZUR GEWERBEORDNUNG FÜR DAS DEUTSCHE REICH § 113 (7th ed. 1925).

61. See, e.g., LAWRENCE SHOFR, THE FORMATION OF A MODERN LABOR FORCE: UPPER SILESIA, 1865-1914, 130 (1975) (on efforts to set up a "blacklist" of workers who quit without giving notice).

62. Of the latter, see HEIN SCHLEßMANN, DAS ARBEITSZEUGNIS (18th ed. 2007) and KARLHEINZ DIETZ, ARBEITSZEUGNISSE: AUSTELLEN UND BEURTEILEN (11th ed. 1999).

63. Judgment of the Federal Labor Court (BAG) of Oct. 25, 1967 reported in Der Betriebs Berater [BB] 1968, p. 546.

formance (*Leistung*) and conduct or behavior (*Verhalten*). The Supreme Court in Civil Matters, the *Bundesgerichtshof* (BGH), has held that the reference bears a two-fold obligation: to benefit the employee by facilitating his or her ability to secure a job—an obligation of benevolence (*Wohlwollen*)—and to benefit the prospective employer by giving the employer an accurate picture an obligation of truthfulness (*Wahrheit*). In the event of a conflict between these two goals, the obligation of truthfulness is supposed to take priority. As the federal labor court, the *Bundesarbeitsgericht* (BAG), put it, “The reference may not contain anything false; it also may not omit that which the reader of a reference expects.”⁶⁴ The legal obligation is one that therefore cannot be contracted around by the employer and employee.⁶⁵ But commentators almost routinely advert to the tension between these dual obligations, if not the impossibility of reconciling them.

In order to police false negatives, not only may an employee seek an order from the labor court⁶⁶ requiring an employer to correct its reference, but in some cases money damages may be sought under the Civil Code, § 280 I BGB, if the employee can prove a breach of the duty and a resulting loss.⁶⁷ In terms of policing false positives, as there is no contractual relationship between the prior employer and the prospective one giving rise to an obligation, § 280 I BGB would not apply. But damages might be available under § 826 BGB which renders a person who “in a manner contrary to good morals [*die guten Sitten*] intentionally inflicts damage to another person” liable for the consequential damages. In fact, in two cases, the BGH did apply § 826 BGB to render a prior employer liable for the economic loss incurred by a current one for the failure of their references to mention that the employee had embezzled. In the first case, the court observed that a reference must contain the basic facts for the total assessment of the employee in the interests of the future employer; that it must do so in order to foster the employee’s career, i.e., the obligation of benevolence, but that it finds its limit—or border (*Grenze*)—in the case where silence provides a basically inaccurate account. In the second case, the employer had given the employee, a bookkeeper, the

64. Judgment of the BAG of July 29, 1971 reported in BB 1971, p. 1280.

65. Judgment of BAG of June 6, 1960 reported in BB 1960, p. 983.

66. The labor court system entails a court of first instance (ArbG) consisting of a professional judge and two lay judges representing employers and employees—the latter meaning union designees. There is a small filing fee and a mandatory effort at conciliation failing which the case is heard. The unsuccessful party may appeal to an intermediate labor court (LAG) composed in the same manner; in effect, it rehears the case. Appeal on legal issues can be taken to the federal labor court (BAG). The vast majority of claims before the labor courts are disposed of in a matter of a few months.

67. Section 280(1) provides: “If the obligor fails to comply with a duty arising under the obligation, the obligee may claim compensation for the loss resulting from this breach. This does not apply if the obligor is not liable for the failure.”

following reference: "We know Mr. Sp. as a reliable and conscientious employee. He has performed all his assigned duties to our complete satisfaction."⁶⁸ Some months later the prior employer learned of the former employee's embezzlement. The BGH held that the prior employer's failure to notify the current employer rendered the prior employer liable in damages for the resulting economic loss.⁶⁹

B. *In Practice*

In practice the obligation to give a benevolent but accurate account of an employee's on-the-job performance and behavior has given rise to an elaborate system couched, in Orwellian terms, in "Reference Speak"—*Zeugnissprache*—the "walking on eggs of coded references."⁷⁰ How this semiotic system works can be gleaned from examples set out in one practical guide,⁷¹ relying on decisions of the labor court, explaining how to phrase the following levels of performance evaluation:

Outstanding Performance

"She has always completed her assigned duties to our fullest [*vollste*] satisfaction."

The author notes that fullest—*vollste*—is not good German, but in *Zeugnissprache* it is the accepted usage.

Above Average Performance

"He has always completed his assigned duties to our full satisfaction."

Note that the employee "always" (*stets*) performed to the employer's "full" (*vollen*) satisfaction.

68. BGH Judgment of May 15, 1979 reported in BB 1980, p. 779.

69. Is it any wonder that Neptuno, a German company hiring a trader to work in Germany, would require that the applicant to supply a reference? See text accompanying *supra* notes 23-25. Is it any wonder then that the prior employer's concealment of critical facts which lead to the employee's hire, and to Neptuno's losses, should have resulted in Neptuno's lawsuit against the reference-giver? What is puzzling is why Neptuno, suing in Illinois where the prior employer was capable of being sued, for an act that had its foreseeable effect in Germany, did not attempt to claim that German law applied. The authors confess that they have not researched Illinois' choice of law rules. But it suffices to say that the Illinois court's opinion, that Neptuno's reliance on the reference was unreasonable, failed to appreciate the legal system in which Neptuno operated.

70. Manfred Schweres, *Zwischen Wahrheit und Wohlwollen: Zum Eiertanz kodierter Zeugniserteilung*, BB 1986, p. 1572. Literally *Eiertanz* is "dancing on eggs."

71. DIETZ, *supra* note 62, at 37-38.

Satisfactory (or Average) Performance

“He has completed his assigned duties to our full satisfaction.”

“Full” but not “always.”

Below Average—between satisfactory and merely sufficient

“He has always completed his assigned duties to our satisfaction.”

“Always,” but not “full.”

Below Average—merely sufficient

“He has completed his assigned duties to our satisfaction.”

Neither “always” nor “full.”

Defective Performance

“For the most part he completed his assigned duties to our satisfaction.”

And some characterizations are simply forbidden, such as the rather arch locution, “You’d be lucky if you could get Mr. X to work for you.”

This merely gives the reader a hint of how the system works. There is a good deal more of what can and what cannot be said. Even the closing of the reference is coded: it has become the norm to wish the departing worker the best of success in her new position and the failure to do so has been litigated as implicitly sending a negative message. Because wishing the worker the best of good health can be taken to signal the prospective employer that the prospect has a health problem, that expression is forbidden.

Germany, as do many other countries, has a wrongful discharge law. As one might expect, cases in which the evaluative content of a reference are in issue are almost invariably cases involving discharge and so reference claims are usually conjoined with wrongful discharge claims. Table 2 sets out the number of wrongful discharge claims brought before the labor courts for the period 1996–2006, and the number of wrongful reference claims in that period; note that the same plaintiff may have brought both.

The sheer number of these claims, which have spiked in recent years,⁷² seems daunting for the legal system to handle given Ver-

72. Grotmann-Höfling has examined the reasons for this spike as possibly explained by the extension of the law to the former East German states which had lacked a similar requirement; to the fact that many of the businesses there to which

TABLE 2: WRONGFUL TERMINATION CLAIMS AND REFERENCE CLAIMS IN GERMANY 1996–2006

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Wrongful termination claims	323,322	320,362	294,164	272,022	258,877	270,594	310,432	343,385	328,635	308,091	244,419
Reference claims	15,395	15,939	17,585	21,254	23,425	25,878	27,908	30,177	31,540	32,288	30,817
Reference claims as % of wrongful discharge claims	4.8%	5.0%	5.9%	7.8%	9.0%	9.6%	9.0%	8.8%	9.6%	10.5%	12.6%

Source: Annual Report of Labor Court Statistics in *Arbeit und Recht* (AuR) 1997–2007.

kerke's caution on the difficulties of litigating levels of employer satisfaction. But these data need to be put in the larger context of turnover in employment. Data are available that disaggregate resignations from involuntary discharges. As the former should be expected to involve negotiation with the employee about the terms of the reference, the latter should be expected to trigger the predominant number of reference disputes. Considering these data, we estimate that in recent years the terms of the reference are legally disputed in about four percent of all involuntary discharges.⁷³

Further insight on how the system works in practice can be gleaned from the statistics of but one labor court for the year 2000 reported by Grotmann-Höfling, which he takes to be fairly typical. In that year, 209 reference disputes were filed with the court. Of these 209 cases, 130 were settled, 63 were withdrawn or closed, 13 resulted

the law applies are small to medium enterprises that lack the sophistication of experienced counsel; to the fact that high and seemingly persistent unemployment may make it worthwhile or even necessary to contest the content of the reference; and to the role of lawyers. Gunter Grotmann-Höfling, *Wohlwollende Wahrheit: Zeugnisse vor dem Arbeitsgericht*, AuR 2003, p. 210.

73. The Institut für Arbeitsmarkt- und Berufsforschung (IAB) annually surveys both resignations and discharges. Unfortunately, it collects data for the first half of the year only. A crude guess at the annual figure would be simply to double these, there being no seasonality in the half yearly construct. Thus, the estimate of four percent is made by doubling the number of discharges and measuring the number of reference claims accordingly. Note that involuntary discharge may be the result of restructuring or downsizing, i.e., the data do not disaggregate economic terminations

in default judgments and only 3 were litigated.⁷⁴ In terms of how the labor court process works it should be recalled that there is easy access, little cost, and lawyers need not be involved. Nevertheless, it is instructive to note that in these 209 cases employees chose to be represented by attorneys in 137 cases and were represented by unions in 30 cases, while employers chose attorney representation in only 30 cases and were represented by an employer association in only 14 cases. Otherwise each party chose to represent itself in conducting these disputes.⁷⁵

C. *Reflections on the German Reference System*

Let us return to Verkerke's main points regarding the economics of mandatory reference disclosure: (1) that verification of an employer's subjective assessments of an employee's performance and behavior is likely to be an exacting and so a costly process; (2) that managers might use the threat of negative assessment as a disciplinary device; (3) that employers might game the system by giving unjustified positive references or by offering them as an inducement to quit, to foist the worker on to another employer; and (4) that any effort to legislate against the potential for gaming or opportunism by requiring truthfulness would involve the same transaction costs as policing negative subjective assessments, and "might prevent em-

from terminations due to incompetence or misconduct. Portions of the relevant IAB data are set out below.

Personnel Outflow in Germany in the First Half of a Year (in thousands)											
	1960	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Resignation on the part of the employee	598	587	546	858	778	736	583	460	388	357	408
Dismissal on the part of the employer	497	509	439	458	422	489	495	522	444	414	364
Expiration of a temporary employment contract	253	239	210	342	266	293	314	278	299	264	247
Termination of a contract by mutual agreement	182	168	130	153	110	110	116	105	95	95	72

SOURCE: IAB Annual Surveys.

74. Grotmann-Höfling, *supra* note 72, at 213.

75. *Id.* The significance of these data is unclear. Large companies tend to have in-house counsel and so employer self-representation in the case of larger companies might be by legally trained company personnel or, perhaps, by human resource managers who have been legally counseled.

ployers from signaling their level of satisfaction with former employees by providing positive references with different degrees of enthusiasm."⁷⁶ Are these borne out in the German experience?

On the first, the snapshot of the sample labor court's docket shows that these cases are rarely litigated, perhaps due to the time and expense of litigation; for the most part the parties negotiate and settle on what the reference will say. Because the reference obligation is woven into the fabric of wrongful discharge law, a feature not present in the United States, the use of this obligation as a bargaining chip by dismissed employees to enhance their entitlement to severance pay, common in Germany, would not be present here.

As to the second proposition, it is fair to assume that the prospect of a negative evaluation could be used as a device to discipline the workforce; but that use is mitigated by the legal obligation of truthfulness as well as benevolence, by the cost the employee can impose on the employer by challenging the reference's terms, and by the risk of money damages should the reference (or the want of one) cost the employee a job.

On the third proposition, the Germans are well aware of the possibility that an employer might sing an incompetent employee's praises in order to get rid of her. In fact, there is a verb—*wegloben* (literally "to praise away")—that means just that.⁷⁷ But the sheer number of reference cases brought belies the idea that employers routinely game the system that way. It appears that the obligation of truthfulness does play a role in what employers say, howsoever hedged by individual bargaining within the confines of the semiotic system. This may be because of the prospect of potential liability to the ultimate employer for an intentional infliction of damages for an omission that is contrary to good morals. The only precedents are of some vintage and only reach silence regarding criminal activity; even so, they stand as a brooding omnipresence of the possible reach of §826 BGB. On the imponderable of "intent" under that provision, a practical guide advises: "The more serious the reference's inaccuracy for the prospective employer's well being . . . the greater would the prior employer's knowledge be that others would be deceived by it."⁷⁸ If a bookkeeper, whose woeful incompetence has cost an employer dearly, is praised by that employer with an intention of foisting her off on another, the second employer conceivably might be able to secure recompense from the reference-giver for the economic loss the employee has caused. Ironically, the prospect of third party liability may have the unintended effect of deterring an employer from saying

76. Verkerke, *supra* note 3, at 168.

77. DIETZ, *supra* note 62, at 17.

78. Schießmann, *supra* note 62, at 164, citing an intermediate civil appellate court decision of 1982.

just how good she thinks an employee is lest the employee underperform in her new position to that employer's detriment.

In other words, the German system solves the coordination problem much as a market mechanism might if the market did not suffer from the transaction costs and information asymmetries that limit a purely private solution to the problem. Verkerke observes of a privately negotiated shared reference pool that, "[a]fter hiring a job applicant, the recipient of a reference ordinarily would discover a former employer's failure to disclose negative information. Presumably, too many incidents of nondisclosure would cause the recipient to terminate the reciprocal relationship."⁷⁹ To analogous effect, Dietz observes of the German system that a prospective employer's selection of employees on the basis of their references depends in part on the prior employer's reputation for giving reliable references.⁸⁰

Finally, the German experience does not confirm the hypothesis that an obligation of truthfulness will deter employers from signaling their levels of satisfaction. For the reason just discussed, both extraordinarily high praise and outright condemnation are most unusual. An employee subject to the latter would be more likely to ask for an unqualified reference; and an employer who would like to give an unusually strong recommendation might bear liability if the employee performs unexpectedly badly. It would take courage to break with the code and say what one really thinks in plain language;⁸¹ and so long as lawyers have a hand in the matter, that courage is rarely manifested.⁸² The result, however, is communication couched in "reference speak" that, once decoded, sends a signal along a finely calibrated scale of levels of performance.

IV. THE PROPOSAL: A STATE-SPONSORED "REFERENCE POOL"

As Verkerke argues, and the German experience confirms, the law is incapable of mandating a "first best" solution to the reference problem. Any system can be gamed or can have unintended consequences. But is a second best solution possible? The desiderata are to have the law induce employers to be more forthcoming with references whilst striving for a balance of accuracy in the information conveyed and fairness to the persons affected by it—at as low transaction costs as possible.

A mandatory reference law on the German model may not be a workable second best solution in the United States: it would allow both employers and employees to game the system—by giving the for-

79. Verkerke, *supra* note 3, at 172 (footnote omitted).

80. DIETZ, *supra* note 62, at 17.

81. Schweres, *supra* note 70, at 1572.

82. Thomas Schraeder, *Zur Steigerung der Zahl der Zeugnisrechtstreite*, AuR 2000, p. 214.

mer a disciplinary cudgel and by giving the latter an entitlement that would allow rent-seeking—when they see it in their interest so to behave.⁸³ Even so, the German experience confirms the intuition that employers will exchange information about employees that can be accurate and fair when they see it is in their interest to do so and that the law can play a role facilitating that exchange. Let us see how that can be done in the U.S. context.

The first element of the proposal is for the state legislatively to create a reference pool, housed, perhaps, in the state's department of labor or similar administrative entity. The costs of the system would be paid by the participating employers and participation would be voluntary: those employers submitting references to the pool would have the right to draw references from the pool. This would solve the coordination problem.

Second, information technology would make submission, access, and retrieval automatic. In fact, the resulting reference database might allow participating employers to search the job market for employees with specific skills, experience, and records of job performance.

A complicating factor is the federal Fair Credit Reporting Act.⁸⁴ Insofar as a "consumer reporting agency" covered by the Act includes an entity that assembles information to be furnished to third parties for employment purposes, not only for a fee but "on a cooperative non-profit basis,"⁸⁵ the fact that the pool is a state agency might not exempt it.⁸⁶ The problem is that the FCRA requires notice to and consent of an employee or prospective employee to the preparation of a report⁸⁷ which would seem to require employee consent before a prospective employer could search the database. What little law there is, however, holds that blanket consent given to an incumbent employer to undertake a check at any time in the future complies with the Act.⁸⁸ There is no reason why consent to release of the reference into the pool would not work as statutory consent for retrieval from the pool by a prospective employer not yet known to the employee. If this reading were disallowed, the applicant would have to consent to each prospective employer's recourse to the pool's database and, if the reference was believed to be too harmful, he or she could decline to consent. Even if the statute were read to require an employer-by-em-

83. Our dubiety about the effectiveness of this legal mandate rests in part on the fact that "the American tradition does not encourage obedience to the state and to the law." SEYMOUR MARTIN LIPSET, *AMERICAN EXCEPTIONALISM* 93 (1996).

84. 15 U.S.C. § 1681 et seq.

85. *Id.* § 1681(a)(f).

86. *Cf. Lewis v. Ohio Professional Elec. Network LLC*, 190 F.Supp. 2d 1049 (S.D. Ohio 2002).

87. 15 U.S.C. § 1681b(b)(2)(B)(ii).

88. *Kelcher v. Sycamore Manor Health Center*, 305 F. Supp. 2d 429 (M.D. Pa. 2004) *aff'd mem.* (3d Cir. 2005).

ployer consent or to disallow any disclosure not expressly consented to, the law would come close to the German model: instead of allowing employees to request an unqualified or qualified reference, the database would indicate that the employee had embargoed it.

The agency administering the pool system could, in consultation with employers, employer associations, unions, and other interested groups, devise a standard form requesting the respondent to supply the information employers most commonly seek, perhaps along the line of the ten questions posed in Table 1. Note that some of this requests specific, factually verifiable information—job qualifications, absenteeism rates, incidents of violence, eligibility for rehire—even as others seek more subjective appraisals of skills and traits. Solicitation of additional information or comment on matters not specifically addressed in the form could also be made.

Third, the affected employees would be given their references, would have the right to request a correction, and, if uncorrected, would have the right to a hearing on the accuracy and fairness of the reference before a hearing officer, as is commonly provided in unemployment compensation challenges, or an arbitrator. An *absolute* privilege would be applied to references issued through the pool if they have not been made subject to a timely demand for correction or after correction made voluntarily or pursuant to administrative or arbitral order. In sum, the reference pool would provide an immunity bath.

The idea that the employee should see the information conveyed about her is scarcely novel. The federal Fair Credit Reporting Act requires that prospective employees on whom prospective employers wish to run background checks be given a copy of the report and be given the opportunity to demand a correction;⁸⁹ and the reporting agency is required to inform the requesting prospective employer that the information is disputed.⁹⁰ Further, nineteen American jurisdictions require private sector employees to be allowed to inspect their personnel records;⁹¹ ten states allow employees to demand a correction of the information contained in their files and, in the event of employer disagreement, provide for inclusion of a written explanatory statement by the employee.⁹²

But more is needed. The value to the employee of adding a written notice of disputed fact or corrective explanation is of dubious value insofar as it does or might merely draw the prospective employer's attention to the dispute—and to the prospect's

89. 15 U.S.C. § 1681, 1681 to (2006).

90. *Id.* § 1681(c).

91. The statutes are compiled in FINKIN, *supra* note 6, at 717-56.

92. They are Connecticut, Delaware, the District of Columbia, Massachusetts, Michigan, Minnesota, Nevada, New Hampshire, Washington, and Wisconsin.

disputatiousness. As Terry Halbert and Lewis Maltby have observed, "Most employees will realize that it is not in their best interests to add a rebuttal to their file, since by doing this they automatically flag themselves as potential troublemakers, and lower their own chances of getting hired again."⁹³ Thus a relatively swift and inexpensive means of checking the reference's accuracy and fairness should be available.

Again, such corrective action is scarcely unknown in American law: at-will public employees who are stigmatized by dismissal and whose stigma then affects their ability to gain employment elsewhere are constitutionally entitled to a "name clearing" hearing in which to set the record straight⁹⁴—indeed it has been held that the mere presence of falsely damaging information in the employee's personnel file triggers the right to a name-clearing hearing.⁹⁵ Military personnel may contest the content of military records;⁹⁶ the federal Privacy Act allows for the correction of facts (but not opinions) contained in federal employee records.⁹⁷ Department of Labor administrative review boards commonly order employers to delete all information pertaining to wrongful discharges under the Surface Transportation Act.⁹⁸ Labor arbitrators routinely order that employee records be corrected or expunged;⁹⁹ indeed, an arbitral order noted earlier in this essay ordered that a stockbroker's Form U-5 be expunged.¹⁰⁰ And two states, Massachusetts and Michigan, allow employees to have their personnel files cleared of information the employer "knew or should

93. Terry Ann Halbert & Lewis Maltby, *Reference Check Gridlock: A Proposal For Escape*, 2 EMPLOYEE RTS. & EMP. POL'Y J. 395, 413 (1998). Note the advice DAC Services gives to truckers in exercising their rebuttal rights under the Federal Fair Credit Reporting Act: "You're within your rights to provide a rebuttal statement for each and every entry on the report but be careful. Too many rebuttals on a report may be viewed by potential employers as being more negative than minor adverse information." *Supra* note 48.

94. *Board of Regents v. Roth*, 408 U.S. 564, 573 (1972) *as refined by* *Paul v. Davis*, 424 U.S. 693 (1976) and *Codd v. Velger*, 429 U.S. 624 (1977). *See, e.g.,* *Brandt v. Board of Co-Op Educ.*, 820 F.2d 41 (2d Cir. 1987).

95. *Sciolino v. City of Newport News*, 480 F.3d 642 (4th Cir. 2007).

96. 10 U.S.C. § 1552.

97. *McCready v. Nicolson*, 465 F.3d 1 (D.C. Cir. 2006); *cf. Mueller v. Winter*, 485 F.3d 1191 (D.C. Cir. 2007).

98. *Griffith v. Atlantic Inland Carrier*, DOL Administrative Review Board Case No. 04-010, Recommended Decision and Order (Oct. 21, 2003) at 28-29.

99. In a case where an employer of casual labor wrongfully placed an employee on "do not refer" for future employment status with the union, and circulated that notice to at least one other employer of union-referred labor in the industry, an arbitrator ordered not only any reference to the letter be expunged from the employee's personnel file but also ordered that a letter of retraction be sent to all persons to whom the earlier notice had been sent. *Shepard Exposition Service*, 122 LA 1725 (Nicholas Duda, Arb., 2006).

100. *See Rosensweig v. Morgan Stanley & Co., Inc.*, *supra* note 38.

have known to be false" in Massachusetts¹⁰¹ or of knowingly false information in Michigan.¹⁰²

In lieu of administrative hearing, the labor pool could maintain a roster of experienced arbitrators to resolve reference disputes. The costs of arbitration would be borne by the employer save that the employee might be required to pay a filing fee as a partial deterrent to frivolous claims. The cost of an arbitration should be modest¹⁰³ as compared to the cost of civil litigation; and apportioning the pool's cost by experience rating, if administrative adjudication were part of the scheme, or having the employer bear the arbitration fee and expenses might in either case mitigate an employer's avidity to use the prospect of false negatives as a disciplinary device.

Moreover, the statute should make it clear that an administrative or arbitral determination of the accuracy of a reference would not be determinative in any wrongful discharge or discrimination claim the employee might bring. To give the reference decision such preclusive effect would mutate a low stakes game into a high stakes one, one likely to ratchet up both cost and delay to the point that it would not be worth the candle.

The greater imponderable is delay as no reference could be drawn from the pool while the employee contested its content. Even so, the employee would not be disadvantaged vis-à-vis those prospective employers who were not participants in the pool. Further, the reference pool administrator could police the expedition with which cases are heard; and there is a good deal of experience with expedited arbitration systems that could be looked to as well.

Thus far, the proposed system would solve the false negative problem. But what about false positives?

If the German experience is relevant, the problem of gaming the system in this way can be expected to be moderated by two considerations. First, American jurisdictions seem to be at 6s and 7s today on whether a duty of full disclosure applies to a reference and, if so, concerning what matters and under what circumstances. The reference

101. Mass. Gen. L. Ch. 149, § 52C.

102. Mich. Comp. L., § 423.505.

103. It takes about a day of arbitral time to hear the average case under collective bargaining agreements, many concerning just cause to dismiss. Set out below are the average arbitral fees and expenses per case for the five-year period 2002-2006. There is no reason to believe that deciding the accuracy and fairness of a job reference should be any more difficult than deciding whether an employee was dismissed for just cause.

Average Labor Arbitral Fee and Expense Per Case				
2002	2003	2004	2005	2006
\$3,202	\$3,412	\$3,542	\$3,733	\$3,940

Source: FMCS (includes travel, hearing, study and decision time compensated on a per diem basis).

pool law, which extends an absolute privilege in any suit brought by the employee, need not take a position on what the rule need be; but it could extend the absolute privilege toward any third party—the prospective employer, its employees or clients—concerning a reference that an adjudicative administrator or arbitrator has determined to be accurate and fair. In principle, the employer is thus at risk of legal uncertainty regarding information it chooses not to disclose; but the law would create a safe harbor for undisclosed information if 1) the employer originally disclosed such information in the reference, 2) it was contested, and 3) then excised by administrative order or arbitral award.¹⁰⁴ This is illustrated in the Mabton¹⁰⁵ case, discussed earlier. Assume the school district had supplied a reference to the reference pool that said that the custodian had “resigned on condition of the withdrawal of what the school district believed were baseless criminal charges of child molestation.” Assume further that the custodian objected to the fairness of the reference, that an arbitrator agreed with the custodian and ordered that portion to be excised. In that case, the prior employer would enjoy absolute immunity in any future lawsuit brought by the custodian’s subsequent employer or other third party based on the reference’s failure to mention those circumstances.

A second factor moderating the prospect of participating employers gaming the system by routinely giving positive references is the fact that the pool is self-selecting and subject to administrative oversight. Because it is self-selecting, it should be expected that the companies to opt in would be those more likely to see the benefits of mutual exchange of good information. As the German experience teaches, the reputational effect on employers who try to use the system to foist bad workers on to others is, in practice, part of the system. Because the system is subject to administrative oversight, an

104. It was just noted that any reference to the employee’s engagement in protected activity as the ground of discharge is commonly ordered excised from the employee’s personnel record by administrative law judges enforcing the anti-retaliation protection of federal transportation safety law. *Griffith v. Atlantic Inland Carrier*, *supra* note 98. In that case, the ALJ also dealt with the company’s participation in the DAC Services termination information pool discussed in *supra* note 48. In *Griffith*, the dismissed truck driver requested that his DAC form be corrected to indicate that he was eligible for rehire, in response to one of the standard entries on the form. The ALJ observed that

if this notation were included on Complainant’s DAC record, this would indicate to future employers that there was a period of time where Complainant was not employed by Respondent without any further explanation, and may be cause for subsequent explanation by Complainant. Therefore, I will instead order that Respondent shall delete any reference to eligibility for rehire. In the event that Complainant should choose not to be reinstated by Respondent, only then should a notation be made on Complainant’s DAC record, that he left in good standing and is eligible for rehire.

Id. at 29.

105. *Supra* note 29.

employer whose positive recommendations are subject to a significant pattern of negative experience reported to the pool administrator by those employers who have relied on them could be barred from further participation.

Consistent with the incidence of actual litigation in the United States, and consistent with the German experience, the percentage of employees contesting their references should be small. Thus, the potential cost to participating employers is of an occasional arbitration over the content of a reference—neither the prospect of significant tort damages nor even the high expenses of civil litigation—in return for which the employer receives absolute tort immunity and gets the benefit of reciprocal access to accurate information in the labor market. In addition, the availability of reliable references may reduce the need for companies to resort to other background checks, thereby reducing the overall transaction costs of the hiring process.